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RUEHBO/AMEMBASSY BOGOTA 7017  
RUEHBR/AMEMBASSY BRASILIA 5774  
RUEHBU/AMEMBASSY BUENOS AIRES 1476  
RUEHLP/AMEMBASSY LA PAZ 2351  
RUEHPE/AMEMBASSY LIMA 0599  
RUEHSP/AMEMBASSY PORT OF SPAIN 3255  
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RUEHDG/AMEMBASSY SANTO DOMINGO 0317  
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C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 002881

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD  
NSC FOR DTOMLINSON

E.O. 12958: DECL: 07/07/2016

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SUBJECT: CNPC'S VIEWS ON THE VENEZUELAN HYDROCARBON SECTOR

REF: 2005 CARACAS 02667

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

11. (C) SUMMARY: CNPC executives are frustrated with the migration of their former Operating Service Agreement (OSA) fields to joint ventures. They do not believe that CNPC is receiving any special treatment from the BRV and argued instead that they are in worse shape than a major American company. They also went to great lengths to assure Petroleum Attache (Petatt) that shipments of Venezuelan crude to China did not represent a threat to USG interests. END SUMMARY

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JOINT VENTURES  
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12. (C) Petatt met with CNPC America President Gong Xun Lu and Vice Presidents Jinling Zhang and Bowen Zhang (strictly protect) on September 18. The meeting was the result of Petatt's assistance in renewing Lu's U.S. visa. Although Lu was less forthcoming than before (Reftel), the atmosphere was relaxed and friendly.

13. (C) According to the minutes from the private sector oil companies' August 2006 Monthly Exploration Luncheon, CNPC will have a 25 percent stake in its new joint venture with PDVSA. The joint venture, when finalized, will be named Petrocaracol and will be composed of CNPC's two former OSA blocks, Caracoles and Intercampo. According to the minutes, average monthly production in Caracoles in August was 4,096 barrels per day with a water cut of 72 percent. The block has 64 active wells. Average production at Intercampo was 15,308 barrels per day with a water cut of 49.5%. Intercampo has 123 active wells. CNPC injected 178,500 barrels of water during August from five injectors. CNPC did not carry out workover or drilling activities in either of the blocks in August.

¶4. (C) Lu began the meeting by raising the migration of the former OSA fields to joint ventures. He stated that PDVSA and the BRV also plan to migrate the three profit sharing agreement fields and CNPC's Orimulsion venture to joint ventures. When asked if there was any timeline for the migration of the four projects, Lu replied in the negative.

¶5. (C) Based on body language and tone of voice, it was clear that the three executives are not happy with the migration of their OSA fields to a joint venture. When Petatt asked the executives what were their biggest worry, Bowen Zhang, after a moment's hesitation, vehemently stated that CNPC wanted PDVSA to either give CNPC complete operational control of the fields or take them back. The spirited nature of his response clearly surprised the other two executives.

¶6. (C) When Petatt noted that the former OSA fields were currently operating in a legal limbo due to the fact that the joint ventures still had not been formed, the CNPC executives admitted that they were concerned about the company's potential liabilities, particularly if there was an accident. Jinling Zhang stated that PDVSA keeps telling CNPC that it has PDVSA's "full support", however, that support does not translate into concrete actions.

¶7. (C) Other oil companies in the past have claimed that CNPC has enjoyed a special relationship with the BRV and PDVSA. When Petatt indirectly raised the issue, all of the executives claimed that they were not receiving any special treatment. Jinling Zhang stated CNPC was in the worst position and claimed that Chevron enjoyed a much better

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relationship with the BRV. Petatt responded that it was his impression that it was more a matter of the luck of the draw rather than BRV policy. Companies that were assigned competent general managers for their new joint ventures were basically satisfied with the migration process, whereas, companies that had incompetent general managers were quite frustrated with the process. The executives stated that this made sense and later stated that all of the companies were being treated the same way by the BRV and PDVSA. It was very clear from the context of the conversation that CNPC is unsatisfied with the new Petrocaracol general manager.

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LABOR ISSUES  
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¶8. (C) During a previous meeting, Lu complained vociferously about Venezuelan labor practices and the lack of a strong work ethic (Reftel). When Petatt raised labor issues, the CNPC executives were non-committal. However, later in the conversation, they stated they were concerned about the new collective bargaining agreement negotiations. Jinling Zhang stated CNPC hoped that labor rates would not increase sharply. However, she added that labor rates have jumped sharply with each new collective bargaining agreement. When Petatt pointed out that the elections in December may give PDVSA and the BRV an added incentive to increase labor rates, Zhang glumly agreed.

¶9. (C) Lu stated that a significant increase in labor rates would make Venezuela even less attractive for foreign investment in the hydrocarbons sector. He opined that a drop in oil prices could result in foreign companies directing their investments to other countries.

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WE REALLY, REALLY LIKE YOU  
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¶10. (C) Petatt concluded the meeting by raising the issue of increased Venezuelan oil shipments to China. Lu visibly stiffened and immediately launched into what appeared to be a pre-programmed speech. He stated CNPC had no intention of diverting any shipments from the U.S. or causing the loss of

a single American job. He stressed CNPC wanted to increase its Venezuelan production and that increased shipments of Venezuelan crude to China would come from increased production, not existing production. He also stated that the China-U.S. relationship was very important and that CNPC did not want to jeopardize it in any way. He then mentioned that transportation costs to China did not make the importation of Venezuelan oil particularly attractive. He stated that until there was a pipeline from Venezuela to the Pacific, Middle Eastern oil was more attractive to China. Lu rattled off a number of statistics on the cost of shipping a metric ton of oil to China from Venezuela to make his point. Unfortunately, Petatt did not catch the figures due to Lu's thick Chinese accent.

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COMMENT  
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111. (C) CNPC executives were clearly frustrated with PDVSA, the BRV, and the progress of the migration of their OSA fields to joint ventures. It was clear from the conversation that they would not be particularly upset if PDVSA took complete control of the Petrocaracol fields. Although the CNPC executives would not comment on the large tax bill that they recently received from the BRV tax authority, it could not have lightened their pessimistic mood. The executives were keenly interested in Petatt's views regarding the coming migration of the strategic associations. After speaking in

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generalities, Petatt pointed out that the final agreements on the strategic associations would provide the template for all future investments in the Faja. The CNPC executives glumly agreed. Ironically, one year ago, CNPC was widely viewed as the BRV's "teacher's pet" with a plethora of special investment opportunities.  
BROWNFIELD